

## **Interim Reporting: Fiscal Year 2008-09 Single Audit**

Employment Development  
Health Care Services  
Rehabilitation  
Social Services  
Transportation



INDEPENDENT NONPARTISAN  
TRANSPARENT ACCOUNTABILITY

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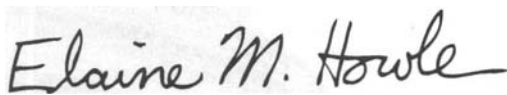
# CALIFORNIA STATE AUDITOR

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Pursuant to guidance issued by the U.S. Office of Management and Budget (OMB), the California State Auditor's Office (State Auditor's Office) presents its interim report concerning various state departments' administration of federal programs during fiscal year 2008-09. With the passage of the American Recovery and Reinvestment Act of 2009 (Recovery Act) comes a renewed emphasis on accountability and public transparency to ensure federal funds are spent properly. A key component of such accountability and transparency is the annual report from the State Auditor's Office on internal control and compliance with federal laws and regulations. OMB's June 2009 guidance stresses the importance of auditors communicating promptly any identified internal control deficiencies to management and those charged with governance. In addition, the guidance states that it is imperative that deficiencies in internal control be corrected by management as soon as possible to ensure proper accountability and transparency for expenditures of Recovery Act awards.

This interim report summarizes audit results pertaining to eight federal programs administered by five departments. The State Auditor's Office has currently identified 24 findings regarding the departments' administration of these federal programs during fiscal year 2008-09. In many cases the findings are recurring issues we identified in past audits. In general, the findings focused on federal requirements regarding eligibility of individuals, whether costs were allowable, and monitoring subrecipients: such as cities and counties, use of funds. The specific federal programs, and their administering state departments, are listed in the table of contents. Where applicable, the State Auditor's Office performed a preliminary review of state departments' methodology for reporting the number of jobs created or retained with Recovery Act funds. Of the five departments, only two-the Department of Rehabilitation and the Department of Transportation-reported jobs created or retained. According to federal guidelines, the remaining three departments were not subject to these reporting requirements. The Department of Rehabilitation followed federal guidance and reported 13 jobs created or retained; however, the 1,590 jobs the Department of Transportation reported as created or retained is overstated by at least 390.



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## Summary

On February 17, 2009, the federal government enacted the American Recovery and Reinvestment Act of 2009 (Recovery Act) to help fight the negative effects of the United States' economic recession. California expects to receive \$85 billion in Recovery Act funding for both new and existing programs. With this increased funding comes a strong emphasis on accountability and public transparency to ensure federal funds are spent properly. A key component of such accountability and public transparency is the California State Auditor's Office (State Auditor's Office) annual report on the State's compliance with federal requirements, such as those identified in the Recovery Act.

The State Auditor's Office prepares its annual report in accordance with the requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133. In June 2009 OMB encouraged auditors to communicate promptly any identified internal control deficiencies to management and those charged with governance. By encouraging prompt communication, OMB intends for recipients, including states, to correct these findings as soon as possible to ensure proper accountability and transparency for expenditures of Recovery Act awards. Based on OMB's June 2009 guidance, the State Auditor's Office presents its interim report concerning the State's administration of selected federal programs receiving Recovery Act funds.

This interim report summarizes audit results pertaining to eight federal programs administered by five departments. The State Auditor's Office has currently identified 24 findings regarding the departments' administration of these federal programs during fiscal year 2008-09. In many cases the findings are recurring issues we identified in past audits. In general, the findings focused on federal requirements regarding eligibility of individuals, whether costs were allowable, and monitoring sub recipients: such as cities and counties, use of funds. Where applicable the State Auditor's Office also performed a preliminary review of state departments' methodology for reporting the number of jobs created or retained with Recovery Act funds. Finally, we made numerous recommendations to the respective departments.

**The Employment Development Department (EDD)** administers the Unemployment Insurance program (Federal Catalog Number 17.225). The Unemployment Insurance program provides benefits to unemployed workers for periods of involuntary unemployment and helps stabilize the economy by maintaining spending power of workers while they are between jobs. During fiscal year 2008-09, EDD spent more than \$14.5 billion in federal funds-of which at least \$471.9 million were funds provided by the Recovery Act for this program. The State Auditor's Office identified one finding as of November 24, 2009, regarding EDD's administration of this program. This finding pertains to EDD's inability to identify all expenditures for two of three program components that were partially funded by the Recovery Act. Specifically, except for the component of its Unemployment Insurance program intended to add \$25 a week to those receiving unemployment payments, EDD is unable to account for or track Recovery Act funds it spent in fiscal year 2008-09. Because this one component of the Unemployment Insurance program is funded exclusively by the Recovery Act, EDD was able to identify that it spent \$471.9 million during fiscal year 2008-09. However, EDD could not tell us how much of the approximately \$4 billion it spent on the two other components of the Unemployment Insurance program came from Recovery Act funds. These two program components were intended to provide unemployed California workers with additional weeks of benefits.

**The Department of Health Care Services (Health Care Services)** administers the Medical Assistance Program (Federal Catalog Number 93.778), commonly referred to as Medi-Cal in California. The objective of Medi-Cal is to provide payments for medical assistance to low-income persons who are age 65 or over, as well as others that meet certain criteria. In fiscal year 2008-09, Health Care Services received \$24.9 billion for this program, including \$2.8 billion in Recovery Act funds. The State Auditor's Office identified seven findings as of December 1, 2009, that pertain to Health Care Services' administration of Medi-Cal. Of these seven findings, five are repeat findings we have disclosed in previous annual audit reports. The audit findings generally focused on whether Health Care Services was making proper eligibility determinations and spending program funds only on allowable costs. For example, one of the tests we perform is to determine whether the State provided drug manufacturers with drug utilization information that is used to generate a rebate for the State. Federal law allows states to receive rebates for drug purchases the same as other payers receive. No later than 60 days after the end of a quarter, the State is required to provide drug utilization data to drug manufactures. These drug manufacturers then have 30 days to pay the State the required rebate or dispute the claim. We tested 40 rebate invoices amounting to \$165.5 million from the third and fourth quarters of 2008, as well as the first and second quarters of 2009, and noted that Health Care Services provided drug manufacturers with utilization data after the 60-day deadline for each quarter tested. For instance, Health Care Services was 11 and 16 days late in providing the utilization data to drug manufacturers for the third and fourth quarters of 2008, respectively. As a result, the State did not obtain the \$165.5 million it was due in a timely manner and potentially missed an opportunity to earn interest on these funds.

**The Department of Rehabilitation (Rehabilitation)** administers the Rehabilitation Services- Vocational Rehabilitation Grants to States Program (Federal Catalog Number 84.126). The objective of this program is to assist states in operating a comprehensive and effective state vocational rehabilitation program. Although during fiscal year 2008-09 Rehabilitation did not spend any of the \$56.5 million the federal government awarded it under the Recovery Act for the vocational rehabilitation grant program, the State Auditor's Office identified five findings as of November 30, 2009, that could affect Rehabilitation's administration of these funds in fiscal year 2009-10 and beyond. In general, these findings focused on federal requirements pertaining to the activities allowed, eligibility, reporting, and matching compliance requirements. Further, the State Auditor's Office performed a preliminary review of Rehabilitation's reporting of job-related data under Section 1512 of the Recovery Act. Based on this preliminary review and Rehabilitation's description of its methodology, it appears that Rehabilitation followed applicable federal guidance when it reported 13 jobs created or retained.

**The Department of Social Services (Social Services)** administers a variety of programs that have been awarded Recovery Act funds during fiscal year 2008-09 including: the State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (SNAP) (Federal Catalog Number 10.561), Temporary Assistance for Needy Families (TANF) program (Federal Catalog Number 93.558), Foster Care-Title IV-E (Foster Care) program (Federal Catalog Number 93.658), and the Adoption Assistance Program (Federal Catalog Number 93.659). All of these programs were collectively awarded \$6.2 billion, including Recovery Act funds totaling \$307.1 million during fiscal year 2008-09, and Social Services spent roughly \$36.8 million in Recovery Act funds on two of these programs. The State Auditor's Office identified nine findings as of December 3, 2009, that pertain to Social Services' administration of these federal programs. The findings concerned a variety of different federal regulations including those governing allowable activities and subrecipient monitoring. For example, although in fiscal year 2008-09 Social Services reimbursed counties approximately \$5.3 billion for the four programs previously mentioned, it did not conduct anyon-site reviews to ensure that counties were spending federal funds only on allowable activities. This is a recurring finding we reported in last year's annual

audit. In fact, of these nine findings, eight are findings we have disclosed in previous annual audit reports. Our testing this year also revealed that Social Services corrected three other findings that we included in last year's annual report.

**The Department of Transportation (Caltrans)** administers the Highway Planning and Construction Program (Federal Catalog Number 20.205). Caltrans uses federal funds under this program for a variety of activities, such as making capital improvements to certain designated highways and providing subgrants to local agencies, such as cities and counties, for similar projects. During fiscal year 2008-09, Caltrans received more than \$2.8 billion in federal funds, of which approximately \$1.2 million—or less than 1 percent—is funding provided by the Recovery Act. The State Auditor's Office has identified two findings as of December 1, 2009, that pertain to Caltrans' administration of this federal program. These findings related to noncompliance with federal requirements concerning allowable costs and subrecipient monitoring. For instance, until it changed its policy in September 2009, Caltrans lacked effective controls to ensure that the progress payments it made to local agencies were reasonable and necessary in relation to the actual work being performed. Under its new policy, Caltrans requires engineers in its district offices to verify that work claimed on progress invoices was actually completed and eligible for reimbursement.

In addition to assessing Caltrans' administration of this federal program, the State Auditor's Office performed a preliminary review of Caltrans' October 2009 reporting of jobs data as required under Section 1512 of the Recovery Act. Based on this preliminary review, we believe that Caltrans followed the Federal Highway Administration's (FHWA) guidance for reporting jobs created or retained. However, the number of jobs it reported is overstated. Specifically, Caltrans reported that it spent \$26.7 million in Recovery Act funds and created or retained nearly 1,590 jobs. Caltrans acknowledged that this jobs figure was overstated for a variety of reasons, including that it had counted jobs on some construction projects twice. Furthermore, Caltrans reported that one or more jobs were created or retained at 152 projects; but 94 of these projects representing 892 jobs created or retained had yet to spend any Recovery Act funds. Therefore, we question the accuracy of the 892 jobs reported for these 94 projects. In fact, the FHWA planned to review states' jobs data to check for errors and one of its validation rules states that if jobs were reported, then Recovery Act funds must have been expended. However, it appears that FHWA did not apply this validation rule.

### **Agency Comments**

We summarized the departments' responses. In general, the state departments concurred with the audit findings discussed in this interim report and plan to take corrective action. However, the departments disagreed with our conclusions in a few cases. In those instances, we have summarized the departments' perspective on these issues, as well as our response, in this interim report.

## Department of Rehabilitation

### REHABILITATION SERVICES-VOCATIONAL REHABILITATION GRANTS TO STATES FEDERAL CATALOG NUMBER 84.126

Based on the U.S. Office of Management and Budget's (OMB) June 2009 guidance, the California State Auditor's Office (State Auditor's Office) presents its interim reporting on the Department of Rehabilitation's (Rehabilitation) administration of the Rehabilitation Services-Vocational Rehabilitation Grants to States (Federal Catalog Number 84.126), or the vocational rehabilitation grant, during fiscal year 2008-09. The issues contained in this interim reporting represent the results of our internal control and compliance audit that require Rehabilitation's corrective action. Under the risk-based approach for selecting grants to audit that OMB Circular A-133 describes, we had previously classified the vocational rehabilitation grant as low risk because we reported no findings for it from our audit covering fiscal year 2005-06. Accordingly, we opted to audit other grants we deemed to be more risky and did not audit this grant during fiscal years 2006-07 or 2007-08. As a result, there were no prior year findings that required follow up during our audit covering fiscal year 2008-09.

The State Auditor's Office identified five findings as of November 30, 2009, that pertain to Rehabilitation's administration of the vocational rehabilitation grant program. Although during fiscal year 2008-09 Rehabilitation did not spend any of the \$56.5 million the federal government awarded it under the American Recovery and Reinvestment Act of 2009 (Recovery Act) for the vocational rehabilitation grant program, we identified internal control issues that could affect Rehabilitation's administration of these funds in fiscal year 2009-10 and beyond.

Further, in October 2009, Rehabilitation submitted its first quarterly report under Section 1512 of the Recovery Act. Section 1512 requires entities that receive Recovery Act funds<sup>1</sup> directly from the federal government to provide, not later than 10 days after the end of each calendar quarter, information concerning how it used the funds. For example, the Recovery Act requires recipients to provide data on the total amount of funds it received and expended, as well as provide information on the projects or activities supported with such funding. According to the federal government, for the quarter ending September 30, 2009, Rehabilitation reported that it had spent \$7.3 million and that 13.33 jobs were created or retained. According to Rehabilitation, these jobs were new limited-term positions for vocational rehabilitation counselors, retired annuitants, and student assistants.

Federal guidelines do not currently require us to, nor did we, audit the information recipients must report under Section 1512. Because Rehabilitation submitted its first Section 1512 report in October 2009, our subsequent audit of fiscal year 2009-10 expenditures of federal funds will likely examine these reports in more detail. Nevertheless, in keeping with OMB's emphasis on early communication of issues to management, we conducted a high-level review of the approach Rehabilitation used to report the number of jobs created with Recovery Act funds. Based on our preliminary review and Rehabilitation's explanation of its approach, it appears that Rehabilitation followed appropriate guidance.

1 OMS issued guidance dated June 11, 2009 (memo M-09-21) clarifying that recipients were not required to submit Section 1511 reports for certain entitlement programs, such as Medicaid.

**Expenditures are Not Always for Allowable Activities**

Rehabilitation did not always ensure that expenditures of vocational rehabilitation grant funds were for allowable activities and costs. To be allowable, vocational rehabilitation services must be appropriately authorized prior to service delivery and must be described in a consumer's individual plan for employment (individual plan). Services to be provided after achieving a successful employment outcome must also be described in an individual plan and must be limited in scope and duration. Rehabilitation incorrectly made payments totaling \$19,300 because it did not follow its processes to ensure that activities are allowable and appropriately authorized.

Of the 46 expenditure transactions reviewed, we found two instances where Rehabilitation paid for unallowable activities and costs. In the first instance, Rehabilitation paid a consumer's postemployment benefits that were not limited in scope and duration, as required by regulation. In this instance, more than five years after the consumer achieved her employment objective in March 2003, Rehabilitation paid for goods and services to support a different employment objective. These goods and services included training for a new job; airfare and hotel to attend the training; a new computer, software, and accessories; and a new cell phone with optical character recognition software. Because Rehabilitation paid for these postemployment expenditures from July 2008 through December 2008 without developing a new individual plan, it incorrectly provided \$15,602 in goods and services to the consumer. In the second instance, Rehabilitation could not provide supporting documentation to verify that \$3,700 in private educational costs were preauthorized by a rehabilitation supervisor, as required. When Rehabilitation incorrectly pays for unallowable activities and costs, it reduces resources available to serve the vocational rehabilitation needs of other eligible consumers.

We recommend that Rehabilitation ensure that staff understand and follow applicable processes, particularly relating to authorizations for postemployment services that are limited in scope and duration and obtaining preauthorizations for services received from private schools. Rehabilitation agreed and stated that it expects the implementation of a new electronic record system, estimated to be complete in October 2011, to improve functionality related to prior approval and the provision of postemployment services. To address issues in the interim, Rehabilitation stated that it has initiated meetings to provide training regarding staff performance gaps and that its rehabilitation supervisors will prioritize manual reviews of the record of services to ensure that all consumer expenditures reflect allowable activities and costs, and are adequately supported by appropriate documentation.

**Time Distributions Are Not Always Supported**

Rehabilitation lacks sufficient policies regarding staff time distribution. Depending on the circumstances, federal regulations require that staff time charged to the vocational rehabilitation grant be supported by either semiannual certifications signed by the employee or their supervisor or monthly personnel activity reports (timesheets) signed by the employee. Rehabilitation uses monthly timesheets to substantiate time distribution. Our review of six employees found one instance in which neither Rehabilitation's headquarters office nor its district office could locate an original, contemporaneous monthly timesheet signed by the employee. Rehabilitation personnel explained that the inability to locate the original timesheet most likely was caused by a combination of limited resources and staff inexperience. We also believe that Rehabilitation's lack of specific written guidance detailing how staff should process and maintain employee time sheets may have contributed to its inability to locate the original timesheet. For example, Rehabilitation has not updated the sections of its policy manual that relate to personnel issues, including timekeeping, since 1985. Without sufficient updated policies regarding staff time distribution, Rehabilitation increases the risk that the staff time charged to the vocational rehabilitation grant will not be sufficiently supported. To minimize this risk, we recommend that Rehabilitation update and implement its policies regarding time distribution to ensure that appropriate support is maintained for personnel costs charged to the grant. Rehabilitation agreed and stated that it clarified roles and responsibilities regarding timesheets in a communication to all department employees in December 2009. Rehabilitation also stated that it plans to conduct training by March 2010 to reinforce the guidance provided in that communication. Finally, Rehabilitation stated that it will update its policy manual in 2010.

### **Eligibility Determinations Are Not Promptly Made and Extensions Lack Support**

Rehabilitation did not always determine applicant eligibility under the vocational rehabilitation grant within the required time period or properly document eligibility extensions. Federal law requires Rehabilitation to determine applicant eligibility within 60 days of initial application status or by the expiration date of an extension that has been agreed upon with the applicant. For six of the 46 applications we reviewed (13 percent), Rehabilitation did not determine eligibility within 60 days or by the expiration of an extension. In three of these six cases, Rehabilitation was less than 31 days late in determining eligibility. For the other three cases, Rehabilitation was from 106 to 401 days late. Further, for two additional applicants Rehabilitation lacked documentation showing an agreed-upon extension date.

When Rehabilitation does not determine an applicant's eligibility within the required time period or does not document extensions in accordance with requirements, it reduces the assurance that applicants promptly receive the required vocational rehabilitation services. Rehabilitation has processes in place to monitor the timeliness of its eligibility decisions; however, such processes were not effective in identifying and correcting these eight exceptions. We recommend that Rehabilitation more closely monitor the timeliness of its eligibility decisions and ensure that it maintains sufficient documentation for time extensions. Rehabilitation agreed with the finding and stated that it expects its implementation of a new electronic record system, estimated to be complete by October 2011, will allow it to more effectively track and monitor eligibility determinations and extensions. Rehabilitation also stated that in the short term, it will emphasize the importance of manually tracking eligibility timelines and extensions using available reports, will reorient counselors and managers to the most effective tracking tools available, and will continue to review eligibility determinations and extensions.

### **Weak Internal Controls Resulted in Inaccurate Federal Reports**

Rehabilitation submitted inaccurate program/cost and financial status reports to the federal government for the vocational rehabilitation grant program. Federal regulations require Rehabilitation to submit accurate reports regarding the status of its vocational rehabilitation grant. Specifically, Rehabilitation must submit an annual vocational rehabilitation program/cost report and quarterly and final financial status reports. Rehabilitation determines the amounts to include on its reports through a process of manual calculations in a series of support schedules that ultimately are based on accounting records and other appropriate supporting documentation (collectively, underlying documentation).

Our review of Rehabilitation's underlying documentation supporting its federal reports identified five errors. The five errors in the underlying documentation led to errors in Rehabilitation's program/cost report for the federal fiscal year ending in 2008, the final financial status report for the 2007 grant, and quarterly financial status reports for the 2008 and 2009 grants. Specifically, in its program/cost report for the federal fiscal year ending in September 2008, Rehabilitation overstated services to individuals with disabilities by \$1.4 million due to a calculation error in the underlying documentation. Additionally, in the remarks section of its final financial status report for the 2007 grant, Rehabilitation overstated costs for one of the reportable activities by \$182 due to an

apparent typographical error. Moreover, Rehabilitation made similar calculation errors in the underlying documentation used to support its quarterly financial status reports for other grant years. For example, in its quarterly financial status report for the 2008 grant (as of December 31, 2008), Rehabilitation understated its total expenditures by \$24,105 because it inappropriately excluded this amount from its underlying documentation. Similarly, in its quarterly financial status report for the 2009 grant (as of December 31, 2008), Rehabilitation overstated total expenditures by \$131,643 because a formula in its underlying documentation did not include all relevant amounts in the calculation. Finally, in its quarterly financial status report for the 2009 grant (as of June 30, 2009), Rehabilitation understated the amount of its cash match by \$40,398 in the remarks section because the person responsible for preparing the report entered an amount from a wrong category in Rehabilitation's accounting records. However, Rehabilitation did not include this last error in other portions of the report. Because it relies on the same underlying documentation to ensure it complies with other federal requirements associated with the vocational rehabilitation grant, such as matching and level of effort, Rehabilitation increases its risk of not meeting these requirements when it fails to detect and correct such errors.

These errors occurred because Rehabilitation lacks internal controls to prevent them. Although an accounting chief's signature on the reports certifies that the reports are correct and complete, it appears that the level of the accounting chief's review was insufficient to detect the types of errors we noted. Also, Rehabilitation does not have formal, written policies and procedures in place to ensure consistent calculation of the underlying documentation used to prepare these reports. We recommend that Rehabilitation institute internal controls, including written procedures for preparing the underlying documentation supporting its reports along with supervisory review, sufficient to detect and correct errors in its reports to the federal government.

Rehabilitation concurred with our finding and stated that it will ensure a more thorough review of the reports and underlying documentation before submission and will develop written procedures and conduct training to support the preparation of the federal financial reports. Rehabilitation also stated that three of the errors we identified—\$1.4 million, \$182, and \$40,398—did not affect the reporting financially.” Notwithstanding its assertion, Rehabilitation submitted program/cost and financial status reports to the federal government that contained inaccurate amounts. As we stated earlier, regulations require Rehabilitation to submit accurate reports.

### **Poor Controls Caused Overstatement of Matching Obligation**

Rehabilitation lacks adequate internal controls to ensure compliance with the federal matching requirement for the vocational rehabilitation grant. Specifically, a supervisor does not review the spreadsheets that staff prepare to document certified expenditure information submitted by its vendors. Federal regulations allow for the value of vocational rehabilitation services provided by state and local government vendors under contract with Rehabilitation to apply toward the requirement for states to match federal funds using nonfederal sources. Under its contract agreement, each vendor must submit a certified expenditure report. An accounting officer-specialist compiles the data from these certified expenditure reports into a summary spreadsheet that Rehabilitation uses to track and total the amounts it uses in helping to meet its nonfederal funds matching obligation. However, we

observed no evidence that the accounting officer-specialist's supervisor reviewed this summary spreadsheet. Without adequate review, the risk of Rehabilitation misreporting or miscalculating its matching share increases.

In fact, during our review of the summary spreadsheet Rehabilitation created to support amounts in the final financial status report (revised as of September 2009) for the 2007 grant, we noted six instances for one vendor where Rehabilitation erroneously included *year-to-date* amounts in the summary spreadsheet rather than *monthly* amounts. Because Rehabilitation uses the totals from this summary spreadsheet to calculate and report the certified expenditure portion of its nonfederal funding, it overreported the amount of its nonfederal matching share for the 2007 grant by \$18,517. We recommend that Rehabilitation establish a supervisory review process of the amounts entered into its summary spreadsheet and used in support of its final financial status report. Rehabilitation concurred with our finding and stated that it will establish a review process for its certified time spreadsheet. It also stated that in more recent years it has been using a standardized template that eliminates the possibility of this type of error from occurring again.